Financial Statements and Report of Independent Public Accountants

For the Years Ended June 30, 2013 and 2012



JUNE 30, 2013 AND 2012

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Office of the Secretary of the Department of Housing and Community Development

Report on the Financial Statements

We have audited the accompanying financial statements of certain Department of Housing and Community Development (DHCD), State Funded Loan Programs, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

DHCD's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the certain Department of Housing and Community Development (DHCD), State Funded Loan Programs, as of June 30, 2013 and 2012, and the respective changes in their financial position and their cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

As discussed in Note 2, the financial statements of the certain Department of Housing and Community Development (DHCD), State Funded Loan Programs, are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the State of Maryland that is attributable to the transactions of the certain Department of Housing and Community Development (DHCD), State Funded Loan Programs. They do not purport to, and do not, present fairly the financial position of the State of Maryland as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hunt Valley, Maryland October 25, 2013

SB + Company, Ifc

Statements of Net Position As of June 30, 2013 and 2012

	2013	2012	
ASSETS			
Current Assets			
Deposit with State Treasurer	\$ 8,794,065	\$ 15,795,555	
Restricted deposits - MD BRAC loans	5,160,656	4,913,627	
State appropriations receivable	21,644,358	17,867,338	
Loans and notes receivable, net	8,503,083	10,528,033	
Accounts receivable	678,831	921,324	
Accrued interest receivable	26,914	26,962	
Real estate owned	-	171,562	
Accounts receivable financing activities		156,250	
Total Current Assets	44,807,907	50,380,651	
Non-Current Assets			
Restricted deposits - CAP	364,895	396,908	
Loans and notes receivable, net	388,815,425	371,572,272	
Total Non-Current Assets	389,180,320	371,969,180	
Total Assets	433,988,227	422,349,831	
LIABILITIES			
Current Liabilities			
Account payable	3,794,081	1,605,089	
Escrow held for borrowers	546,390	546,116	
Other liabilities	130,272	130,272	
MD BRAC notes payable	-	1,250,000	
Total Current Liabilities	4,470,743	3,531,477	
Non-Current Liabilities			
Restricted deposits - CAP	364,895	396,908	
MD BRAC notes payable, net of current portion	3,786,250	2,486,250	
Total Non-Current Liabilities	4,151,145	2,883,158	
Total Liabilities	8,621,888	6,414,635	
Unrestricted Net Position	\$ 425,366,339	\$ 415,935,196	

Statements of Revenues, Expenses and Change in Net Position For the Years Ended June 30, 2013 and 2012

	2013	2012	
Operating Revenues			
Interest	\$ 9,184,391	\$ 10,515,622	
Charges for services and fees	164,190	607,024	
Other	846,997	455,548	
Total Operating Revenues	10,195,578	11,578,194	
Operating Expenses			
General and administrative	6,512,623	6,477,753	
Servicer fees	398,158	386,300	
Foreclosure expenses	124,878	183,999	
Provision for loan losses	14,134,071	16,683,903	
Grants	4,851,147	5,223,021	
Total Operating Expenses	26,020,877	28,954,976	
Operating Loss	(15,825,299)	(17,376,782)	
Non-Operating Revenues			
State contributions	25,256,442	24,282,856	
Change in net position	9,431,143	6,906,074	
Net position, beginning of year	415,935,196	409,029,122	
Net Position, End of Year	\$ 425,366,339	\$ 415,935,196	

Statements of Cash Flows For the Years Ended June 30, 2013 and 2012

	2013		2012	
Cash Flows from Operating Activities		_		_
Cash Receipts:				
Interest	\$	7,558,287	\$	7,658,997
Payoffs of loan principal		6,145,959		4,060,937
Principal repayments		8,503,389		9,133,397
Charges for services and fees		164,190		607,024
Revenue sharing and other		846,997		455,548
Recovery on loan losses		7,433		56,503
Sales of owned real estate		494,356		251,624
Total Cash Receipts		23,720,611		22,224,030
Cash Disbursements:				
General and administrative		6,957,688		6,898,796
Foreclosure expenses		161,187		144,066
Financing loans		40,017,693		39,421,752
Grants		5,024,176		4,841,316
Total Cash Disbursements		52,160,744		51,305,930
Net Cash From Operating Activities	((28,440,133)		(29,081,900)
Cash Flows from Non-Capital Financing Activities				
Contributions from outside sources, net		206,250		1,050,000
Prior year State contribution included in receivables		,		-,,
from the State		(3,777,020)		(7,856,984)
State contributions		25,256,442		24,282,856
Net Cash From Non-Capital Financing Activities		21,685,672		17,475,872
Net decrease in cash and cash equivalents		(6,754,461)		(11,606,028)
Deposit with State Treasurer and Restricted Deposits, beginning of year		20,709,182		32,315,210
Deposit with State Treasurer and Restricted Deposits, End of Year		13,954,721	\$	20,709,182
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Statements of Cash Flows (continued) **For the Years Ended June 30, 2013 and 2012**

	2013	2012
Cash Flows from Operating Activities		
Reconciliation of operating loss to net cash from operating activities:		
Operating loss	\$ (15,825,299)	\$ (17,376,782)
Effect of changes in non-cash operating assets and liabilities:		
Accounts receivable and accrued interest	242,541	(441,297)
Loans and notes receivable	(15,218,203)	(11,219,861)
Accounts payable	2,188,992	127,602
Escrow held for borrowers	274	-
Real estate owned	171,562	(171,562)
Total adjustments	(12,614,834)	(11,705,118)
Net Cash From Operating Activities	\$ (28,440,133)	\$ (29,081,900)

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION

The Department of Housing and Community Development (DHCD) was formed in 1987 (Chapter 311, Acts of 1987) and charged with the administration of State Funded Loan Programs (SFLP). DHCD is a cabinet level agency that reports annually to the Governor and the General Assembly on its financial health. DHCD was created to work with partners to finance housing opportunities and revitalize great places for Maryland citizens to live, work and prosper. SFLP are among many groups of loan programs administered by the State of Maryland (the State). SFLP are a part of DHCD and do not operate as a separate legal entity or agency of the State. The summary outlined below highlights the various SFLPs administered by DHCD.

A. Rental Housing Programs

Authority: Article - Housing and Community Development,

Maryland Housing Rehabilitation Program Multi-Family and Non-Profit

Rehabilitation Program §§4-901 through 4-923, §4-929, §4-933;

Rental Housing Production Program §§4-1501 through 4-1511; Elderly Rental

Housing Program §§ 4-401 through 4-409; and §4-501 and §4-504

The Rental Housing Programs are comprised of the Elderly Rental Housing Program (ERHP), created in 1984; the Rental Housing Production Program (RHPP), created in 1986; the Maryland Housing Rehabilitation Program-Multifamily Rehabilitation Program (MHRP-MF), created in 1977; and the Nonprofit Rehabilitation Program (NRP), created in 1986. The programs aim to increase and preserve affordable rental housing for occupancy by families of limited or low-income, including individuals and elderly households (30%-80% of area median income). Financing is provided in the form of loans for affordable rental housing development including apartments, rental town homes, congregate housing, singleroom occupancy, emergency shelters, assisted living and shared living facilities. Projects may be restricted to elderly residents or special needs populations. The maximum loan amount is \$2,000,000; however, the limit may be waived on a case-by-case basis. Recipients agree to rent the units to income-eligible residents for the greater of 15 years or as long as the loan is outstanding. In 1998 the General Assembly passed legislation authorizing use of the RHPP Program for the conversion of older commercial and office buildings to market rate rental housing in designated revitalization areas in order to promote economic diversity and revitalization. A general fund appropriation was also provided in support of the initiative at that time. However, the Office Space Program is currently inactive. Rental Housing Works (RHW) was added in FY 2013 as an initiative to stimulate the economy by increasing new construction and renovation of rental housing developments statewide.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

B. MD-BRAC Preservation Loan Fund

The purpose of the MD-BRAC Preservation Loan Fund is to leverage DHCD, federal, local and private funds to preserve affordable rental housing by providing flexible, short-term (typically 12-36 months) loans to spur additional affordable rental housing preservation activities in the MD-BRAC geographic footprint. Projects eligible for financing must be existing multifamily rental housing with a demonstrated need for short-term financing. Multifamily rental housing may include apartment buildings, townhouses, single room occupancy (SRO) and shared housing facilities with five (5) or more units. The Fund's definition of rental housing preservation is intentionally broad, and will extend to properties that will ultimately include all or only a portion of their units restricted to households at moderate and low income levels. Projects that do not currently meet affordability standards will be required to institute income and rent restrictions following receipt of the MD-BRAC Preservation Loan. Units must be restricted as affordable for a period of no less than 10 years. "Affordable" means rental housing with existing income or rent restrictions, or housing with rents that are affordable to households that earn up to 100% of County or Area Median Income, whichever is greater.

C. Homeownership Programs

Authority: Article - Housing and Community Development, §\$4-801 through 4-810; §\$4-814 through 4-816; 4-301 through 4-309; § 4-501 and \$4-502

The Homeownership Programs provide low interest rate mortgages for low and moderate income first-time homebuyers who would otherwise lack the resources to purchase a home. The program began in 1970. The program includes the Downpayment and Settlement Expense Loan Program (DSELP), which provides funds for down payment and settlement expenses, and the Maryland Home Financing Program (MHFP), which makes direct loans to households to purchase homes or to disabled borrowers or borrowers with a disabled child or eligible family member under the Homeownership for Individuals with Disabilities Program. Financing is provided in the form of a loan. Regulations covering the Programs, are found at COMAR 05.03.01, and 05.03.04.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

D. Special Loan Programs

Authority: Article – Housing and Community Development, §§4-901 through 4-923, §4-926, §4-927 and §4-933, for the Maryland Housing Rehabilitation Program, Indoor Plumbing Loan Program and the Accessory, Shared and Sheltered Housing

Program

Article – Housing and Community Development, §§4-701 through 4-712 for the Lead Hazard Reduction Grant and Lead Hazard Reduction Grant Program and Lead Hazard Reduction Loan Program

Article – Housing and Community Development §\$4-601 and §4-612 for the Group Home Financing Program

Article – Housing and Community Development §4-501 and §4-505

The Special Loan Programs provide preferred interest rate loans and grants to low and moderate income families, sponsors of rental properties occupied primarily by limited income families, and non-profit sponsors of housing facilities, including group homes.

The programs are designed to bring housing up to code and to remediate lead paint hazards that are present in the housing stock and/or acquire, construct and modify homes suitable for use as group homes for persons with special housing needs. A listing of various activities conducted within the Special Loan Programs follows.

Maryland Housing Rehabilitation Program

The Maryland Housing Rehabilitation Program – Single Family (MHRP-SF) was effective August 3, 1977. The purpose of the program is to extend loans to eligible individuals and sponsors to finance the rehabilitation of housing occupied by families of limited income. The loan funds are used to eliminate health, safety and maintenance deficiencies and eliminate the residential properties' health, safety and maintenance deficiencies and ensure compliance with applicable housing codes and standards. The requirements of the program are outlined in COMAR 05.04.01.

Accessible Homes for Senior Homeowners Grant Program

The Accessible Homes for Senior Homeowners Grant Program is effective October 1, 2013. The purpose of the program is to finance accessibility-related renovation or repair activities for elderly homeowners. Program requirements are being drafted in response to the legislation passed in the 2013 session.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

D. Special Loan Programs (continued)

Indoor Plumbing Loan Program

The Indoor Plumbing Program (IPP) was effective August 28, 1986. The purpose of the program is to make loans to or for the benefit of individuals with limited income to finance indoor plumbing pipes, equipment, wells, septic tanks, or other on-site sewage systems or connection to community water and sewage systems. The requirements of the program are outlined in COMAR 05.04.05.

Accessory, Shared and Sheltered Housing Program

The Accessory, Shared and Sheltered Housing Program (ASSP) was effective August 28, 1986. The purpose of the program is to make loans to or for the benefit of individuals with limited income to finance rehabilitation projects to provide housing opportunities for families of limited income by creating accessory, shared and sheltered housing facilities. The requirements of the program are outlined in COMAR 05.04.08.

Lead Hazard Reduction Grant and Loan Program

The Lead Hazard Reduction Grant and Loan Program (LHP) was effective August 28, 1986. It was previously called the Residential Lead Paint Abatement Program. The purpose of the program is to extend loans and grants to eligible individuals, child care centers and sponsors to finance the lead hazard reduction in residential housing units. The requirements of the program are outlined in COMAR 05.04.06.

Group Home Financing Program

The Group Home Financing Program (GHFP) was effective February 23, 1987. The purpose of the program is to provide loans to sponsors to finance the costs of acquiring, constructing, and modifying or refinancing buildings or to refinance loans which will provide or maintain group homes for low-income, elderly, handicapped, disabled, and other residents of the State with special housing needs. The requirements of the program are outlined in COMAR 05.04.09.

E. Neighborhood Revitalization Programs

Authority: Article – Housing and Community Development, §§6-301 through 6-311. Regulations concerning the program are found at COMAR 05.13.01

Neighborhood Business Development Program

The Neighborhood Business Development Program, operating as Neighborhood Business Works (NBW) was established October 1, 1995, to provide flexible gap financing for small businesses starting up or expanding in designated sustainable communities throughout Maryland. Loans are made to Maryland-based local development corporations, microenterprises, non-profit organizations, or small businesses.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

E. Neighborhood Revitalization Programs (continued)

Loans and grants are made to these organizations whose activities contribute to a broader revitalization of the sustainable community (e.g., reuse of vacant/underutilized buildings or providing needed goods or services to area residents). Financing ranges from \$1,000 up to the lesser of (i) \$500,000 or (ii) 50% of the total project costs. Loan applicants must provide a cash contribution of at least 5 percent of the total project costs. Regulations concerning the program are found at COMAR 05.13.01.

Capital Access Program

The Capital Access Program (CAP), a component of NBW, was established October 1, 2000, to stimulate the provision of private capital to small businesses in Priority Funding Areas throughout the State. This program stimulates private sector lending to small businesses by offering an incentive to private lenders to make loans to borrowers that otherwise might not qualify for conventional loans. It enables private lenders to establish a loan loss reserve fund from fees paid by borrowers, lenders, and the State. Enrolled amounts may range from \$1,000 to \$1,000,000, and either the entire loan or a portion of the loan may be enrolled. Up to \$1 million from the annual appropriation for the Neighborhood Business Development Program may be used for this program.

Legislative changes to the Neighborhood business Works Program in 2004 gave the Department the ability to:

- Assign or sell up to \$4 million in loans from the BBDP each year, generating funds for new loans to small businesses. The loans can be sold to national partners, such as the Community Reinvestment Fund, who support neighborhood revitalization initiatives and purchase loans from state and local governments.
- Expand eligible uses of the Program to include microenterprises, creating jobs and expanding economic opportunities for lower income individuals and neighborhoods.

Legislative changes to the Neighborhood Business Works Program in 2010 gave the Department the ability to:

Expand lending to microenterprises by reducing administrative barriers to making
microloans and provide better access to capital for establishing and sustaining microbusinesses. This change also authorizes the Department to provide financial assistance
to a certain entity for the purposes of the entity making subloans to eligible
microenterprises. Eligible microenterprises will have less than five employees and can
receive loans up to \$35,000.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

E. Neighborhood Revitalization Programs (continued)

Terms are typically less than five years and rates and fees will vary depending on the size of the loan, loan underwriting and market conditions, but would be below the rates charged for comparable loans by the U.S. Small Business Administration which currently range from 8 to 13 percent. On average, a combined interest rate of 5-7% would be the maximum rate goal predicated on credit and capacity to repay the loan.

F. Community Legacy Program

Authority: Article – Housing and Community Development, Title 6, Subtitle 2, §§ 6-201 through 6-213. Regulations concerning the program are found at COMAR 05.17.01

Community Legacy Program (CLP) improves the effectiveness of State support for neighborhood revitalization by complementing and supplementing existing resources. The program provides gap resources to stabilize or revitalize communities located in Sustainable communities, and in accordance with Sustainable Community Plan. Sustainable Community Areas are a result of the 2010 Sustainable Communities Act that created a consolidated area for revitalization investment. Sustainable Community Areas were formerly known separately as Community Legacy Areas and Designated Neighborhoods and also now include Base Realignment and Closure (BRAC) Zones and designated Transit Oriented Development (TODs).

For example, the following activities have been included in Community Legacy applications:

- Strategic acquisition or demolition of deteriorated buildings or sites where a redevelopment project has not yet been identified;
- Streetscape improvements, including lighting and sidewalk improvements;
- Other infrastructure improvements needed to attract investment, including parking and improvements to pedestrian and bicycle circulation.

The Neighborhood Intervention Component of the Community Legacy Program is intended to function as a preventative measure either in or outside of a Sustainable Community to address problem properties that are having a negative impact on the community. The two eligible uses of a Neighborhood Intervention Project are:

- To buy properties that need rehabilitation and redeveloping the properties through rehabilitation, demolition, reconstruction or re-use; or
- Strategically demolishing buildings that are dangerous for use or occupancy, or so deteriorated that rehabilitation is not feasible, and preparing the property for revitalization, redevelopment or re-use.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

G. Strategic Demolition and Smart Growth Impact Fund (SDSGIF)

Authority: Chapter 424, Laws of Maryland 2013, SA24; Chapter 423, Laws of Maryland 2013, 81. SOOA24.02

The Strategic Demolition and Smart Growth Impact Fund (SDSGIF) seeks to catalyze activities that accelerate economic development, job production and smart growth in existing Maryland communities. The SDSGIF aims to improve the economic vitality of "grey field development" which often faces more barriers than sprawling "green field development". Awards focus on smart growth projects that can have a high economic and revitalization impact in their existing communities. Projects will be located in designated Sustainable Communities throughout Maryland. Sustainable Communities are areas found within Priority Funding Areas (PFAs) and are targeted for revitalization.

H. Baltimore Regional Neighborhood Initiative (BRNI)

Authority: Supplemental Budget No. I, House Bill 100/Senate Bill 125: 80.S00A24.01 and 82.S00A24.02

Created as a pilot in the 2013 Maryland General Assembly Session, the Baltimore Regional Neighborhood Initiative (BRNI) is a recommendation of the House Regional Revitalization Workgroup, organized by Speaker Michael Busch.

BRNI aims to demonstrate how strategic investment in local housing and businesses can lead to healthy, sustainable communities with a growing tax base and enhanced quality-of-life. The pilot initiative targeted communities located in either Baltimore City and/or the Inner Baltimore Beltway communities of Anne Arundel and Baltimore Counties where modest investment and a coordinated strategy will have an appreciable neighborhood revitalization impact.

Eligible applicants for the initiative are nonprofit community development corporations or coalitions. Eligible projects include residential and/or commercial projects, such as strategic property acquisition, redevelopment, rehabilitation and new infill development that build upon existing strengths and assets to achieve healthy residential markets and economic growth. Eligible applicants and their projects must have a revitalization plan and must be located within an approved Sustainable Community.

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

I. Partnership Rental Housing Program

Authority: Article - Housing and Community Development, §§4-1201 through 4-1209.

The purpose of the program is to expand the supply of affordable housing for low-income families through a partnership between the State and local governments. The program was created in 1988 as a pilot program and was enacted as a permanent program in fiscal year 1991. In 1993, the program was expanded to provide a resource to fund replacement public housing for Baltimore City. In 2006, the program was further expanded to provide additional funds for projects in order to create housing for low-income individuals with disabilities. Financing is provided in the form of deferred loans to projects that can be maintained economically as lower income housing in perpetuity if the owner so wishes. Except in the case of housing for individuals with disabilities, residents must contribute maintenance or other services to the facility, grounds or neighborhood. Regulations covering the program are found at COMAR 05.05.05.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

SFLP utilize the enterprise fund accounting method for financial reporting purposes in accordance with governmental accounting principles generally accepted in the United States of America. The accompanying financial statements present the financial position, change in financial position and cash flows of SFLP.

The GASB issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre- November 30, 1989 FASB and AICPA Pronouncements, in December 2010, effective for financial statement periods beginning after December 15, 2011. In November 2010, the GASB issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, and Statement No. 61, The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34, effective for periods beginning after December 15, 2011 and June 15, 2012, respectively. In addition, in June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for periods beginning after December 15, 2011. The SFLP has implemented the above GASB statements, and they have no material effect on the financial position of the SFLP.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, and Statement No. 66, *Technical Corrections* – 2012 – an amendment of GASB Statements No. 10 and No. 62, effective for periods beginning after December 15, 2012. In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans* – an amendment of GASB Statement No. 25, and Statement No. 68, *Accounting and Financial Reporting for Pensions* – an amendment of GASB Statement No. 27, effective for periods beginning after June 15, 2013, and 2014, respectively.

Notes to the Financial Statements June 30, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A. Basis of Accounting (continued)

In January 2013, GASB issued Statement No. 69, Government Combination and Disposals of Government Operations, effective for periods beginning after December 15, 2013. In April 2013, GASB issued Statement No. 70, Accounting and Financial Reporting for Non-exchange Guarantees, effective for periods beginning after June 15, 2013. The SFLP will implement these statements as of their effective dates. While the SFLP is still in the process of determining the effect of implementing these GASB statements, the SFLP does not expect a material impact on the financial statements.

B. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Actual results could differ from these estimates.

C. Relationship with the State

SFLP are just a few of the many programs administered by DHCD and the State. Other State agencies, such as the Department of Budget and Management, support DHCD by providing services for DHCD and thus allocate a portion of their expenses to DHCD. SFLP have no direct employees and are entirely supported by staff at DHCD to perform all necessary functions of SFLP. DHCD allocates certain operating, general and administrative costs to SFLP, which is DHCD's estimate of its cost to manage and administer SFLP's operations. This allocation from DHCD is not necessarily representative of SFLP cost as if they were a stand-alone entity and could significantly change in the future. SFLP records these costs as invoiced by DHCD for the fiscal year. However, the allocation is subject to review and adjustment subsequent to year end. Any adjustment is included on the invoice and recorded in the period in which the adjustment is identified.

SFLP's accompanying financial statements are not indicative of SFLP as if it were a standalone entity. SFLP are included in the enterprise funds of the State.

D. Acquired Property

Properties acquired as a result of foreclosures are carried at the lower of principal balance at the date of the ratified foreclosure or at management's estimate of the net realizable value of the property less estimated expenses and losses related to the maintenance and sale of the property. As of June 30, 2013, SFLP had no acquired properties, and in 2012 SFLP acquired properties was \$171,562.

Notes to the Financial Statements June 30, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Revenues and Expenses

SFLP distinguish operating revenue and expenses from non-operating items. Operating revenues and expenses generally result from mortgage lender activities in connection with SFLP's ongoing operations. The primary operating revenues are interest income on loans. Operating expenses include expenses relating to the servicing of the loans, provision for loan losses, asset management, salaries, and administrative expenses. Non-operating revenues and expenses include payments related to participants in MD BRAC and contributions from the State. To the extent considered to be material by management, loan origination fees and costs are capitalized and amortized over the estimated life of the related loans.

3. CASH AND CASH EQUIVALENTS

A. Definition

SFLP define cash and cash equivalents as cash and short-term investments that are held on deposit with the State Treasurer and any unspent appropriations. Cash receipts and disbursements of SFLP are made through a cash pool maintained by the State Treasurer. The cash is invested under the State's guidelines. Additional information can be obtained from the State of Maryland Comprehensive Annual Financial Report.

As of June 30, 2013 and 2012, SFLP had deposit balances with the State Treasurer and restricted deposits of \$13,954,721 and \$20,709,182, respectively. This balance included short-term investments of \$1,269,296 and \$1,370,147 as of June 30, 2013 and 2012, respectively.

B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SFLP adhere to Maryland State Treasurer's policy for managing its exposure to fair value loss arising from increasing interest rates. The Maryland State Treasurer's investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Treasurer's Office will not directly invest in securities maturing more than five years from the date of purchase.

C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. SFLP's policy for reducing its exposure to credit risk is to comply with the Maryland State Treasurer's policy, which requires that the Treasurer's investments in repurchase agreements be collateralized by U.S. Treasury and agency obligations. In addition, investments may be made directly in U.S. Treasuries or agency obligations.

Notes to the Financial Statements June 30, 2013 and 2012

3. CASH AND CASH EQUIVALENTS (continued)

D. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. SFLP's policy for reducing this risk of loss is to comply with the Maryland State Treasurer's policy, which limits the amount of repurchase agreements to be invested with a particular institution to 30 percent of the portfolio. Otherwise, there is no limit on the amount that may be invested in any one issuer.

E. Restricted Deposits

Under GASB Statement No. 34, net position should be reported as restricted when constraints placed on net position use are either: externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other government; or are imposed by law through constitutional provisions or enabling legislation. Accordingly, all funds and accounts whose purpose is to pay future claims are restricted as to their use, as is interest earned on these restricted assets.

One of the SFLP's programs, CAP, designed to enable private lenders to establish a loan loss reserve fund from fees paid by borrowers, lenders, and the State. CAP is exempt from the requirements of Title 6, Subtitle 2 of the State Finance and Procurement Article, which is the source of the State's investment policy (specifically, Section §6-223 of the Finance and Procurement Article).

CAP is exempt from the requirement cited in that section by virtue of Article – Housing and Community Development, Section §6-309(f)(2), which specifically exempts DHCD's contributions from the requirements of Title 6, Subtitle 2. Therefore, CAP reserve accounts are not required to be under the \$250,000 maximum insurance coverage per account from the Federal Deposit Insurance Corporation (FDIC).

The CAP reserves are restricted deposits in what management believes to be high quality financial institutions. However, to the extent that each of these accounts exceeds \$250,000, they are exposed to custodial credit risk as the excess is both uninsured and uncollateralized. As of June 30, 2013, the combined restricted cash bank and book balance was \$364,895 of which \$39,173 was uninsured and uncollateralized. As of June 30, 2012, the combined restricted cash bank and book balance was \$396,908 of which \$38,752 was uninsured and uncollateralized.

As of June 30, 2013, the MD BRAC program had \$5,160,656 in cash. As of June 30, 2012 the MD BRAC program had \$4,913,627 in cash. This program is restricted to making loans for the specific purpose of providing multifamily developers with short term loan financing. These developers will help to alleviate the impact of the Base Realignment and Closure (BRAC) initiative in the Counties surrounding the Fort Meade area.

Notes to the Financial Statements June 30, 2013 and 2012

3. CASH AND CASH EQUIVALENTS (continued)

F. Custodial Credit Risk-Deposits

Custodial credit risk is the risk that, in the event of a bank failure, SFLP's deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in SFLP's name. SFLP do not have a formal deposit policy for custodial credit risk, but follow the Maryland State Treasurer's policy which states the Treasurer may deposit in a financial institution in the State, any unexpended or surplus money in which the Treasurer has custody. As of June 30, 2013 and 2012, all of the SFLP's cash was deposited with the State Treasury, and this was not subject to custodial risk.

4. LOANS AND NOTES RECEIVABLE, NET OF ALLOWANCE

Loans are stated at the amount of unpaid principal adjusted for any write-offs, allowance for loan losses, and deferred fees or costs on originated loans.

The allowance for loan losses is established through a provision for loan losses when management believes that repayment of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible, based on current factors and prior loan loss experience.

Current factors include, but are not limited to, changes in the composition and volume of the loan portfolio, overall portfolio quality, and review of specific problem loans in conjunction with the current economic conditions that may affect the borrower's ability to pay.

While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in the factors considered, such as the economic condition of the borrower or certain related industry concentrations. All loans are for property located within the State of Maryland.

Management considers a loan to be impaired when the loan is 60 days delinquent from its stated repayment terms. As of June 30, 2013 and 2012, there were 991 and 897 loans, respectively, with outstanding principal of \$19,427,354 and \$20,010,252, respectively, considered impaired and written down to their estimated net realizable value.

Notes to the Financial Statements June 30, 2013 and 2012

4. LOANS AND NOTES RECEIVABLE, NET OF ALLOWANCE (continued)

Composition of SFLP Loan Portfolio

SFLP established a 100 percent allowance for loan losses on all Partnership Rental Housing Program loans because the program is such that the loans do not have to be repaid as long as the borrower complies with the terms of the program and continues to use the property in accordance with regulatory agreements. For the years ended June 30, 2013 and 2012, the provision for loan losses includes \$3,965,836 and \$5,369,430, respectively, related to loans issued during the year from the Partnership Rental Housing Program.

The change in the allowance for loan losses was as follows for the years ended June 30, 2013 and 2012:

	 2013	 2012
Beginning balance	\$ 269,113,429	\$ 252,724,943
Provision for loan losses	14,134,071	16,683,903
Loans (written off)	 (266,823)	 (295,417)
Ending Balance	\$ 282,980,677	\$ 269,113,429

Notes to the Financial Statements June 30, 2013 and 2012

4. LOANS AND NOTES RECEIVABLE, NET OF ALLOWANCE (continued)

Composition of SFLP Loan Portfolio (continued)

	Number of	(Outstanding	Allowance for		Allowance for Loans/N	
As of June 30, 2013	Loans/Notes		Principal	I	Loan Losses	Re	eceivable, Net
Rental Housing Programs*	353	\$	286,618,679	\$	44,313,875	\$	242,304,804
Homeownership Programs	11,785		96,842,335		14,836,684		82,005,651
Special Loan Programs	1,757		73,333,410		16,430,916		56,902,494
Neighborhood Revitalization							
Programs	196		30,328,804		16,005,995		14,322,809
Partnership Rental Housing							
Programs	88		191,337,957		191,337,957		-
BRAC - MF loans	1		1,300,000		55,250		1,244,750
Loans receivable	14,180		679,761,185		282,980,677		396,780,508
Notes receivable	1		538,000		-		538,000
Total Loans and Notes							
Receivable	14,181	\$	680,299,185	\$	282,980,677	\$	397,318,508

^{*}Includes Construction Loan Program

As of June 30, 2012	Number of Loans/Notes	(Outstanding Principal	 llowance for Loan Losses	 Loans/Notes eceivable, Net
Rental Housing Programs*	331	\$	270,116,882	\$ 36,346,428	\$ 233,770,454
Homeownership Programs	11,116		89,630,387	13,198,145	76,432,242
Special Loan Programs	1,713		72,700,344	16,759,557	55,940,787
Neighborhood Revitalization Programs	197		29,606,000	15,384,053	14,221,947
Partnership Rental Housing					
Programs	86		187,372,121	187,372,121	-
BRAC - MF loans	1		1,250,000	 53,125	 1,196,875
Loans receivable	13,444		650,675,734	269,113,429	381,562,305
Notes receivable	1		538,000	-	538,000
Total Loans and Notes				 	
Receivable	13,445	\$	651,213,734	\$ 269,113,429	\$ 382,100,305

^{*}Includes Construction Loan Program

Notes to the Financial Statements June 30, 2013 and 2012

5. NOTE PAYABLE

In April 2010, the DHCD obtained a loan from the John D. and Catherine T. MacArthur Foundation to foster and enable preservation of affordable housing for low-income persons and families near military bases in those counties in Maryland which are impacted by the Base Realignment and Closure initiative (BRAC). The entire potential amount of the loan is \$4,000,000, of which \$3,000,000 has been received as of June 30, 2013. DHCD is required to make quarterly payments of interest on the unpaid principal balance. Principal payments due, as of June 30, 2013, are shown below assuming DHCD will receive the additional \$1,000,000.

DHCD Loan principal payback schedule due to MacArthur Foundation

Date	Amount
April 1, 2018	\$ 1,000,000
April 1, 2019	1,000,000
April 1, 2020	2,000,000
-	\$ 4,000,000

Interest expense for the years ended June 30, 2013 and 2012 was \$60,000 and \$40,000, respectively, at the rate of 2% per year.

In FY 2012, Montgomery County, Harford County, and Howard County committed matching funds for participation in the Base Realignment and Closure initiative (BRAC). As of June 30, 2013, SFLP had received \$50,000 from Harford County. As of June 30, 2013, total notes payable for BRAC is \$3,786,250. This balance includes the following loans received from MacArthur Foundation as well as several Maryland counties as shown below:

Lagne	Pavable	as of June	30	2013
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MacArthur Foundation	\$	3,000,000
Montgomery County		320,000
Harford County		150,000
Howard County		160,000
Baltimore County		156,250
Total loans payable	\$	3,786,250

The funds have been committed for no less than 10 years unless DHCD fails to fulfill any or all of its obligations related to the program. The Counties may terminate their association with BRAC if the default by DHCD is not cured with 30 days. If the default is not cured within 30 days DHCD will reimburse the Counties' contributions in excess of any loan fund dollars applied towards County projects, subject to the available balance in the MD BRAC Loan Fund.

Notes to the Financial Statements June 30, 2013 and 2012

6. COMMITMENTS

As of June 30, 2013, SFLP committed to provide \$82,408,487 in loans and is holding \$546,390 in escrow accounts for borrowers.

7. PENSION AND OTHER POSTRETIREMENT BENEFITS

Eligible employees who perform services for SFLP and employees of the State are covered under the retirement plans of the State Retirement and Pension System of Maryland (the System) and are also entitled to certain healthcare benefits upon retirement. SFLP's only liability for retirement and post-employment benefits is its required annual contribution to DHCD, which in turn was paid in full to the State of Maryland prior to year end. The System is considered part of the State's financial reporting entity, and is not considered a part of SFLP's reporting entity. The System prepares a separate Comprehensive Annual Financial Report, which can be obtained from the State Retirement and Pension System of Maryland at 120 East Baltimore Street, Baltimore, Maryland 21202.